

BEFORE THE
Federal Communications Commission JUN 29 1994
WASHINGTON, D.C.

Implementation of Section 19)	
of the Cable Television Consumer)	
Protection and Competition)	
Act of 1992)	
)	CS Docket No. 94-48
Annual Assessment of the)	
Status of Competition in the)	
Market for the Delivery of)	
Video Programming)	

COMMENTS OF TELE-COMMUNICATIONS, INC.

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APPENDIX A

Statement of Dr. John C. Malone, President and Chief Executive Officer, Tele-Communications, Inc. Before the Subcommittee on Antitrust, Monopolies and Business Rights, Committee on the Judiciary, United States Senate, December 16, 1993

APPENDIX B

Stanley M. Besen, Steven R. Brenner and John R. Woodbury, An Economic Analysis of the FCC's Proposed Cable Ownership Restrictions, Charles River Associates, Inc., February 9, 1993

SUMMARY

The economic literature clearly establishes that quantitative tests do not adequately measure the degree of competition and consumer choice in dynamic markets. This is especially true in the video programming distribution market where the various distributors differentiate themselves not merely by price, but by the services they offer. Determining whether this marketplace is sufficiently competitive to eliminate the need for regulation will require complex and sophisticated analyses -- analyses that go beyond mechanical application of the 1992 Cable Act's 50-15 effective competition test. TCI believes the Commission should urge Congress to revise the 50-15 test to permit cable operators to submit evidence that a market is effectively competitive even though the rigid numerical test is not met.

In connection with the Commission's assessment of horizontal and vertical integration in the cable industry, attached to these comments is testimony TCI President and CEO John Malone recently presented to the Senate Subcommittee on Antitrust, Monopolies and Business Rights. TCI believes that an accurate picture of the industry's current vertical and horizontal status requires a recognition that such ownership patterns provide very significant consumer benefits. In this regard, also attached is an economic paper prepared by Charles River Associates which TCI submitted in an earlier Commission proceeding.

Finally, TCI urges the Commission not to adopt mandatory reporting requirements. Such reports would be an additional and unnecessary burden on cable operators. Publicly available reports, along with information gleaned from complaints made under the Commission's rate and program access regulations, provide adequate information to the Commission.

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COMMENTS OF TELE-COMMUNICATIONS, INC.

Tele-Communications, Inc. ("TCI") hereby submits its comments in the above-captioned proceeding.¹

I. INTRODUCTION

Since the Commission's 1990 Cable Report,² the video distribution marketplace has changed significantly. Technological improvements, changes in regulatory policy, court decisions, and increased availability of capital have resulted in the emergence, or prospective emergence, of new multichannel

¹ In the Matter of Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992, Annual Assessment of the Status of Competition in the Market for Delivery of Video Programming, Notice of Inquiry, CS Docket No. 994-48, FCC 94-119 (rel. May 19, 1994) ("Notice" or "NOI").

² Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, MM Docket No. 89-600, 5 FCC Rcd 4962 (1990) ("1990 Cable Report").

video distribution competitors and increased the viability of existing competitors.

While reasonable people may disagree on the precise extent of competition and the rate at which it is growing, it is certain that the next few years will see substantial growth both in the number of players distributing video programming and the number of video distribution technologies reaching the American consumer. High-power Ku-band DBS, C-band home satellite dishes ("HSD"), and MMDS already offer financially viable, competitively-priced alternatives to cable. New technologies, such as video dialtone, are emerging as formidable competitors.

Determining whether this marketplace is sufficiently competitive to eliminate the need for regulation will require complex and sophisticated analyses. Simple quantitative measurement alone will not be sufficient to assess the amount of consumer choice and competition, especially since the services provided by the various distributors, as well as the prices they charge, will differ.

In this regard, TCI believes the 50-15 test in the 1992 Cable Act³ is an inadequate measure of competition. It may be relatively simple to administer, but this simplicity is also its downfall. Mechanical formulae by themselves cannot accurately portray the state of competition in a complex, dynamic marketplace such as video distribution. As explained more fully below, TCI believes the Commission should urge Congress to revise

³ 47 U.S.C. § 542(1)(1).

the 50-15 test to permit cable operators to submit evidence that a market is effectively competitive even though the rigid numerical test is not met.⁴

Below, we also discuss the following: 1) the trend toward increased competition among alternative video distribution systems; 2) the issues of vertical and horizontal integration; and 3) the lack of necessity for periodic mandatory reporting by industry participants.

II. THE 1992 CABLE ACT SHOULD BE AMENDED TO PERMIT THE COMMISSION TO MAKE QUALITATIVE ASSESSMENTS OF THE STATE OF COMPETITION

Standard measures of industry concentration, such as the 50-15 test, or even the more sophisticated Herfindahl-Hirschman Index (HHI), are predicated on the existence of a fairly standardized product, or at least an unchanging product mix, offered by the firms in an industry. Given this premise, such measures are then used to identify changes in the structure of the industry, number of firms, shares held by each, etc., in order to draw inferences about the extent of competition.

However, when the mix of products being produced by firms is itself changing rapidly, and especially when new products are continually being offered, static measurements provide an unrealistic picture of the behavior of firms, and are

⁴ Alternatively, the Commission should consider using its existing waiver authority to relieve cable operators from rate regulation upon appropriate demonstration of competition, even where the 50-15 test is not met.

less adequate indicia of competition.⁵ Consider a market with two firms -- Firm A has a 90% market share and Firm B has a 10% market share. If both firms offer the same product, one would expect price to be the principal form of competition -- Firm A would set its prices with reference to whether Firm B could increase its output by lowering price and thereby take customers away from Firm A.

On the other hand, if the two firms provide different products, and products that are changing, competition between them would take additional forms. In this case, it would be much more difficult for Firm A to simply set its prices with reference to Firm B's ability to increase output, since Firm B might respond by changing its product offerings, as well as its price. Here, competition is multi-faceted -- based on non-price factors as well as price.

Yet, the 50-15 test might lead to the conclusion that competition was the same in both situations described above. Thus, while static measurements, such as the 50-15 test, may provide some insights into the extent of competition, they are not sufficient for judging the competitiveness of dynamic markets. In such markets, other issues, such as whether the products are homogeneous and unchanging, or diverse and dynamic, must also be considered.

⁵ See Scherer & Ross, Industrial Market Structure and Economic Performance, at 279-280, for a discussion of the influence of product heterogeneity on competition ("Scherer & Ross").

Professors Ordover and Willig have rigorously developed the argument against the application of static economic theory (such as market share and concentration analysis) to technologically dynamic industries:

The economic foundations of antitrust policy rest largely on static analysis, while the foundations of our economy have become increasingly dynamic. It may be illogical and socially harmful to apply the static equilibrium framework to industries where technological progress is rapid and competition is driven by product and process innovation. To be sure, current product market structure in such industries affects current pricing decisions, but it may also affect the rate and direction of inventive activity. These latter effects may be the more important, as over the long run the gains to society from continuing innovation are vastly greater than those associated with competitive pricing.⁶

Markets in which service offerings are changing rapidly may be far more competitive than markets with the same structure and a more stable set of products. There is no doubt that the video distribution market falls into the former category -- rapid changes in service offerings characterize the market today and will increasingly characterize it over the next several years.

Moreover, the 50-15 test does not adequately take into account the competitive effects of the alternative distribution systems that have already achieved a "toehold" presence in the market. Fringe competitors already in the market may thwart the

⁶ Janusz A. Ordover and Robert D. Willig, Antitrust for High-Technology Industries: Assessing Research Joint Ventures and Mergers, 28 J. L. & Econ. 311, 311-313 (1985) (quoting Richard Nelson & Sidney Winter, The Schumpeterian Tradeoff Revisited, 73 Am. Econ. Rev. 114 (1982)). See generally Joseph Schumpeter, Capitalism, Socialism, and Democracy (1950).

anticompetitive tendencies of larger incumbents.⁷ For example, if a firm with a relatively low market share can easily expand its output in response to a price increase from a larger firm, the smaller firm could restrain the ability of the larger firm to implement such an increase. This is particularly likely to occur if the market is one in which there are large fixed costs and low variable costs, i.e., the investment required to enter the market was relatively large, but the cost to add customers after entry was achieved was relatively small.⁸ This is the case both for DBS and video dialtone. It would be relatively easy for either type of distributor to raise output in response to price increases by cable operators, since their satellite and video dialtone costs are largely sunk and their costs of adding new customers are very low by comparison.

For these reasons, TCI believes the 50-15 test should be amended to permit cable operators to submit evidence to overcome the presumption that a market is non-competitive even where alternative distributors in aggregate have less than 15% penetration in a market. The Commission should be permitted to recognize the variety of competitive effects that cannot be captured by the 50-15 test. TCI urges the Commission to recommend such a modification to Congress.

⁷ Scherer & Ross, at 276-279.

⁸ Id. at 289.

III. COMPETITIVE DISTRIBUTION SYSTEMS

In its 1990 Cable Report the Commission predicted:

The degree of competition confronting cable is expected to increase over time. Rivals such as SMATV, MMDS, home satellite dishes (HSDs), and second cable systems will probably expand their coverage, and DBS service may begin to have a significant impact in four or five years.⁹

The Commission was prophetic -- cable's rivals are increasingly providing competition in the delivery of video programming. TCI welcomes this competition for two reasons. First, the advent of competition will hasten the elimination of the 1992 Act rate regulation scheme which TCI believes is unduly burdensome and delays innovation. Second, TCI believes that cable technology, and the industry's entrepreneurial pedigree, will enable it to prosper in the competitive marketplace.

TCI is not privy to the proprietary marketing plans and strategies of alternative video service providers. However, as the Commission points out in the Notice, and even a cursory review of the current trade and financial press makes clear, competition among well financed competitors is increasing in the video marketplace.¹⁰

A. MMDS

The ability of MMDS to compete with cable is growing for two reasons: First, MMDS's capital costs per subscriber are

⁹ 1990 Cable Report at ¶ 47.

¹⁰ See Notice at ¶ 18; Tom Kerver, The Dawn of Competition, Cablevision, May 23, 1994 at 71 ("Kerver").

lower than cable's, enabling MMDS operators to achieve profits quickly.¹¹ Second, there has been growing interest on the part of lenders in MMDS. As one MMDS operator put it, more has happened in the last two years than in the past twenty years in terms of MMDS financing.¹²

There are approximately 500,000 MMDS subscribers, and independent parties forecast that this number will rise eightfold by the end of the decade.¹³ The financial markets have validated these predictions: the number of publicly traded MMDS stocks has jumped from four to nine in just the last six months.¹⁴

Ironically, one of the few remaining hurdles for MMDS operators in offering effective and viable competition to cable operators is the Commission's current 3-5 year backlog of MMDS applications. However, the Commission recently transferred responsibility for MMDS and MDS to the Common Carrier Bureau and Chairman Hundt has pledged to Congress to reduce this backlog.¹⁵

¹¹ E. Gerard, The Wireless Cable Industry -- Industry Report, Gerard Klauer Mattison & Co., January 21, 1993 at 1 ("Gerard").

¹² Rich Brown, Wireless Cable Seeks Bank Approval, Broadcast & Cable, August 9, 1993, at 30; see also Gerard, at 2.

¹³ See Kerver, at 88.

¹⁴ Id.

¹⁵ FCC Daily Digest, FCC 94-146, June 9, 1994; FCC Promises Final PCS Decision, Hints at Cable TV 'Incentives', FCC Report, June 2, 1994.

B. High Power Ku-Band DBS

High power Ku-band DBS is now widely available (C-band HSD has been available since the early 1980s) to cable households and by this summer will be offering a combined 300 channels of programming to consumers.¹⁶ Two DBS operators are exceptionally well-capitalized and appear to be legitimate competitors to cable right from the start -- DirecTV, a subsidiary of Hughes Communications, itself a subsidiary of General Motors, and United States Satellite Broadcasting ("USSB"), a subsidiary of Hubbard Broadcasting.¹⁷

According to USSB President and CEO Stanley Hubbard, DBS will capture 50 million subscribers within ten years.¹⁸ Even if the number of subscribers turns out to be significantly fewer, DBS operators will be profitable. Hubbard characterizes DBS as "still a great business" even if the ten year number turns out to be 10 million instead of 50 million,¹⁹ and DirecTV has stated that it alone expects to have 10 million subscribers within six years and that it will break even with as few as three million subscribers.²⁰ Since both DirecTV and Hubbard anticipate that

¹⁶ See Kerver, at 82.

¹⁷ Primestar is the third DBS operator and is owned by a group of cable operators which includes TCI, Time Warner, Comcast, Continental, Cox and Newhouse.

¹⁸ DBS Challenge to Cable, Television Digest, March 28, 1994.

¹⁹ DBS Challenge to Cable, Television Digest, March 28, 1994.

²⁰ See Kerver, at 84.

60% of their subscriber base will be lured from cable,²¹ DBS offers a direct and substantial competitive threat to cable.

C. C-Band Home Satellite Dishes

The HSD industry now serves over 2.5 million homes and is growing at the rate of over 30,000 new HSD subscribers per month.²² Also, HSD offers consumers approximately 250 channels of programming. HSD systems remain a formidable and significant competitor to cable -- particularly in rural areas where dish size is not a major impediment to consumer acceptance.

D. Video Dialtone

In addition to MMDS, DBS, and HSD, telcos also are gearing up to compete in video distribution.²³ There have been 27 video dialtone applications filed with the Commission. Five applications have been granted.²⁴

²¹ Eric Shine, The Little Dish That Could. . . ? Business Week, April 4, 1994 at 43.

²² Margaret Parone, Direct to Home: Politics in a Competitive Marketplace, Satellite Communications, February 1994, at 28.

²³ See Chesapeake and Potomac Tel. Co. v. U.S., 830 F. Supp. 909 (E.D. Va. 1993), Amended Final Order, Civ. No. 92-1751-1 (October 7, 1993), appeal docketed, Nos. 93-2340 and 93-2341 (4th Cir. October 15, 1993) (holding section 533(b) of the Communications Act unconstitutional as applied to Bell Atlantic within its service areas); U.S. West, Inc. v. U.S., No. C93-1523R (W.D. WA. June 15, 1994).

²⁴ Application of the Chesapeake & Potomac Telephone Co. of Virginia, File No. W-P-C-6834, 8 FCC Rcd 2313 (1993); Application of New York Telephone Co., File No. W-P-C-6836, 8 FCC Rcd 4325 (1993); Application of the Southern New England Telephone Co., File No. W-P-C-6858, 9 FCC Rcd 1019 (1993); Application of U S West Communications Inc., File No. W-P-C-6868, 9 FCC Rcd 184 (1993); and Application of Rochester Telephone Corporation, File No. W-P-C-6867, DA 94-275 (1994).

There can be no doubt about the ability of the telcos to provide effective competition to cable. The scope of the individual video dialtone applications, as well as the number of such applications that have been filed over a brief period of time, attest to the enthusiasm of the telcos to compete in video distribution as well as the regional and national nature of the competition.

IV. VERTICAL AND HORIZONTAL INTEGRATION

The growth in both the number of video programming distribution technologies, and the number of players offering these services to the public, renders the extent of vertical and horizontal integration within the cable industry a much less relevant inquiry. As competition emerges, the proper inquiry is the extent of integration in the video programming distribution marketplace taken as a whole -- not in each of its component parts.

Nonetheless, it is evident from the Notice that the Commission has significant information on the state of vertical and horizontal ownership in the cable industry. TCI need not summarize this publicly available information here. However, in order to assist the Commission in assessing the industry in general and TCI in particular, attached to these comments is testimony TCI President and CEO John Malone recently presented to the Senate Subcommittee on Antitrust, Monopolies and Business Rights.

In addition, TCI believes that an accurate picture of the industry's current vertical and horizontal status requires a recognition that such ownership patterns provide very significant consumer benefits. In this regard, also attached is an economic paper prepared by Charles River Associates which TCI submitted in an earlier Commission proceeding.²⁵ The paper analyzes vertical integration and horizontal concentration in the cable industry and TCI believes it will be useful in the Commission's analysis in this proceeding. In order to further assist the Commission, TCI summarizes several of the principal points from the paper below.

A. Benefits of Vertical Integration

Vertical integration between MSOs and cable program services lowers costs, leading to reduced prices and increased service quality to the viewing public.²⁶ In fact, limiting vertical integration can increase production costs leading to reduced quality, and even discouraging the introduction of innovations such as digital compression by reducing the returns to innovative activity.²⁷

B. Benefits of Horizontal Concentration

Common ownership of cable systems by MSOs leads to significant efficiencies both in the acquisition and marketing of

²⁵ Besen, Brenner and Woodbury, "An Economic Analysis of the FCC's Proposed Cable Ownership Restrictions," (February 9, 1993) ("Besen et al").

²⁶ Besen et al. at 23.

²⁷ Id. at 23-24.

program services, and in the planning and developing of new technologies and services. These efficiencies may be realized directly not only by the cable systems, but also by program services that find dealing with a smaller number of buyers reduces their costs of developing and marketing services.²⁸ Moreover, larger MSOs are more likely to participate in the innovation of new program services, a role they have played historically. Efficiencies that lower the costs of cable systems or program services may, in turn, be passed on to consumers in the form of lower rates.²⁹

V. MANDATORY REPORTING REQUIREMENTS

The Commission seeks comments on whether it should establish mandatory annual reporting requirements to collect data for its reports to Congress on the state of competition in video distribution. It also asks whether such mandatory requirements are authorized by Sections 19(f)(2) and 3(g) of the 1992 Cable Act, or its general licensing authority.

TCI believes the Cable Act does not authorize mandatory reporting requirements. Section 19(f)(2) authorizes the collection of documents necessary to assess any alleged violation of Section 19 (the anti-discrimination provision). Section 3(g) authorizes the collection only of financial information necessary to enforce the rate regulation provisions. The fact that

²⁸ Id. at 6-9.

²⁹ Id.

Congress found it necessary specifically to authorize the collection of information for these limited purposes suggests that a broader general authority to impose mandatory reporting requirements apart from the Cable Act does not exist.

Even if the Commission does have authority to impose mandatory reporting, it is unnecessary and would be counterproductive for it to do so. First, as noted, there are extensive publicly available reports on the structure of the cable industry. These reports are updated regularly and cover every facet of the industry. Second, the complaint processes under the Cable Act and the Commission's rules will provide additional information to allow the Commission to analyze the industry. For example, the documentation generated by rate complaints should enable the Commission to track and analyze the impact of the Act's rate regulations on industry pricing. Similarly, program access complaints should generate sufficient information to enable the Commission to determine whether alternative distributors are obtaining access to programming. Should either of these areas generate minimal complaints, that would constitute compelling evidence that rates and program access are not a problem and that the regulations, much less mandatory reporting, are not necessary.

The imposition of mandatory reporting requirements will impose significant burdens on cable operators. It is especially important that the Commission avoid such burdens now. The 1992 Act has already placed on cable operators a large and

inordinately complex set of obligations. Cable operators have been forced to divert very substantial time and resources to respond to the new regulatory regime. TCI submits that the obligations already imposed by the Act and the Commission's rules are enough and that no additional resources need be diverted from the industry's principal task of providing high quality entertainment and information to its customers.

Respectfully submitted,

TELE-COMMUNICATIONS, INC.

A handwritten signature in cursive script, reading "Michael Hammer", is written over a horizontal line.

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Statement of

Dr. John C. Malone

President and Chief Executive Officer

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Before the

Subcommittee on Antitrust, Monopolies and Business Rights

Committee on the Judiciary

United States Senate

December 16, 1993

Mr. Chairman, members of the Subcommittee, my name is John Malone. I am the President and Chief Executive Officer of Tele-Communications, Inc. ("TCI").

I appreciate the opportunity to come before you this morning to talk about our company's merger with Bell Atlantic and about our vision of the future. I regret that I was unable to join my colleague Ray Smith when he appeared before you earlier this year. I appreciate the Subcommittee's willingness to accommodate my schedule by giving me this chance to come before you today.

I would like to discuss briefly how TCI got to where it is today and where it is I believe we are headed. I would also like to offer the Subcommittee my views on some of the competition policy issues that have been brought to your attention. Then I will attempt to answer your questions.

I. TCI - THE GROWTH AND EVOLUTION

Sparked by dramatic increases in the processing and storage capacity of tiny computer chips, an enormous revolution in the way Americans communicate with one another is now underway. Our children routinely will use an array of competing communications networks to control thousands of video, data and telephone options that promise a richer, more productive and satisfying life for all. From our children's perspective, I am certain the first bold steps we are now taking in optical fiber, digital television, video switching and related technologies will be recognized as the dawning of the Information Age.

This is a revolution from within. The President and Vice President of the United States, the latter with particular effectiveness, have heralded its coming and established the information superhighway as a critical national objective. Leaders in Congress have pledged their support and are now drafting the regulatory ground rules under which it will operate.

The private sector has responded by committing billions to the construction of full service networks and services that will appear on them. Companies such as AT&T and McCaw, USWest and Time Warner, Southwestern Bell and Cox, Bell Canada and Jones Intercable, and Bell Atlantic and my company are organizing themselves to build a new national Infostructure that will bring several of them in direct head-to-head competition with one another.

No sector of our nation's economy holds more promise or commands greater excitement today than the telecommunications industry. Yet, it would be foolish for any one person or company to take credit for these developments. Rather it is the working of a free and entrepreneurial marketplace, where companies and combinations of companies are rushing to be first, that has made the difference.

Most of the telecommunications giants that are involved can trace their lineage back to the turn of the century or before, but our company TCI is only 25 years old this year. Neither the Congress, the press nor many customers took much notice in 1968 when Bob Magness, our Chairman and Founder, turned his back on the cottonseed business forever and started TCI. Few cared as we

flirted with insolvency for many months before and after my arrival as CEO of the company in 1972. Our obscurity was well-earned in those days as we struggled long hours with the fundamentals of our business.

Most of those who went through those tortured first years with Bob and me are still with our company today. Few recognized that the rough trails we blazed in those days would be guideposts for the information superhighway of tomorrow.

However, I am pleased to say the business principles that guided us as we achieved financial stability then are the same ones that guide us today, and the ones that will be the foundation for the merged Bell Atlantic and TCI.

First, we will continue to be agents of change. For most of us, television 25 years ago was three or four local VHF broadcast channels. Today, we have ten times the number of choices and, in many cities, more. Premium and pay-per-view channels provide additional markets for movie studios, and we even have more broadcast choices, since cable has extended the reach of hundreds of UHF broadcast stations making them economically viable.

The compressed digital systems we will begin to deploy next year represent the first step in giving our customers even more choice and more control over their television service. Within three years, we will be deploying interactive full service networks with powerful computing devices in the home to give customers random access to stored and real time video programming, data and telephone products.

Certainly, everyone in the television business is not advantaged by change. Some of those who have dominated television for forty years are outright opposed and, regrettably, they have occasionally gained allies in the Congress.

However, the dramatic pace of technological development has made change inevitable. Our philosophy has been to lead in some areas, to follow in others, but to seek acceleration of change on nearly every front. We know change is likely to bring our customers more choice and control over their television service.

A second principle that has served us well is our view that we are purchasing agents for our customers. Basically, we purchase video programming wholesale and sell it retail. If wholesale prices can be maintained at a reasonable level, our customers pay less for cable service.

Despite our best efforts, programming costs have escalated dramatically over the last five years--several hundred percent in our case--although much of that can be accounted for by significant increases in the quality of cable programming.

Nevertheless, we bargain hard with our programmers, and occasionally the resulting frictions have been brought to the attention of Congress. Most Members have been reluctant to interfere in such commercial disputes, especially when they are reflected in litigation, but there have been exceptions.

A third principle has been constant reinvestment in our business. At TCI, we do not pay dividends to our shareholders and we have never reported material annual earnings during the entire 25 years of our existence. Excess cash flow goes back